No. 84-1737

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1984

UNITED STATES OF AMERICA
Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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Question Presented

The Internal Revenue Code and Regulations impose a tax on the "unrelated business income" that an otherwise tax-exempt organization receives from trade or business activities which are not "substantially related" to, *i.e.* do not "contribute importantly" to, the performance of its educational functions constituting the basis for its exemption. The question presented is:

Whether on the record in this case the court of appeals properly held that advertisements in the scholarly journal of a medical association, organized and exempt for charitable and educational purposes pursuant to Section 501(c)(3) of the Code, which relate solely to the practice of internal medicine, are "substantially related" and "contribute importantly" to the tax-exempt purposes of that organization and thus are not subject to the unrelated business income tax.

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STATEMENT OF THE CASE

This case involves the taxation of advertising income of organizations otherwise exempt from taxation under the Internal Revenue Code. The issue is best understood in the context of the history of the relevant Code provisions and the implementing regulations of the Internal Revenue Service ("IRS"). Section 501 of the Code defines 23 categories of organizations that are exempt from taxation, in accordance with the purposes for which they are organized. Of particular relevance here are two subsections: (c)(3), covering organizations formed and operated exclusively for charitable, scientific, educational and like purposes, and (c)(6), covering business leagues,

chambers of commerce, real estate boards, boards of trade and professional football leagues.[1]

In the Revenue Act of 1950, Congress enacted provisions subjecting to taxation the income of an exempt organization received from any "unrelated trade or business" it regularly carried on.[2] IRC §§511(a), 512(a). In Section 513(a) Congress defined an "unrelated trade or business" as

> any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

As to several specified categories of organizations, including those exempt under subsection (c)(3) but not subsection (c)(6), Congress also provided that such income would nevertheless not be taxable if the trade or business of the organization was carried on "primarily for the convenience of its members, students, patients, officers, or employees." §513(a)(2).

Respondent American College of Physicians ("the College") is an association exempt from tax pursuant to

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1. In addition to differences in purpose, (c)(3) organizations, unlike (c)(6) organizations, are limited with respect to political activity and lobbying. §501(c)(3).

2. Prior to the 1950 legislation, all income received by tax-exempt organizations was free of tax. In response to certain situations where exempt organizations were receiving income from wholly unrelated businesses, Congress enacted the 1950 amendments in an effort to tax such income. "The 1950 Act was a fairly limited measure, designed to distinguish the customary activities of exempt organizations from the operation of independent business enterprises entirely unrelated to" the purpose of the organization justifying exempt status. *American College of Physicians v. United States*, 530 F.2d 930, 933 (Ct. Cl. 1976). *Accord, Massachusetts Medical Soc'y v. United States*, 514 F.2d 153, 155 (1st Cir. 1975). As the court noted in *American College*, "[t]he publication of advertising in tax-exempt educational journals was a well-established practice before 1950." 530 F.2d at 933.

Section 501(c)(3). As stated in its Articles of Incorporation, the College's tax-exempt purposes are, *inter alia*, (1) to uphold and to maintain high standards in medical education and medical practice; (2) to encourage research, especially in clinical medicine; and (3) to foster measures for the prevention of disease and for the improvement of public health (C.A. App. 19A). Its members consist solely of members of the medical profession engaged in practice, teaching, research or other pursuits in the field of internal medicine or in allied or related specialties. In 1975, the College had approximately 32,000 members. (C.A. App. 19A).

In furtherance of its exempt purposes, the College publishes *Annals of Internal Medicine* ("*Annals*"), sponsors a comprehensive annual post-graduate session, international and regional educational programs, and offers post-graduate continuing education for physicians. (C.A. App. 19A, 26A-28A). *Annals* contains scholarly articles relevant to the practice of internal medicine and is one of the most highly regarded medical journals in the field of internal medicine in the world. (C.A. App. 19A). *Annals* is provided to the College's members without charge other than dues, is available to non-members on a per-issue basis or by subscription, and is circulated in medical schools and in medical and non-medical libraries throughout the world. Its circulation in 1975 was roughly 73,000. (C.A. App. 19A).

Each monthly issue of *Annals* contains advertisements relating solely to medical products, supplies and equipment useful in the practice of internal medicine, and notices of positions available in connection with the practice of internal medicine.[3] Approximately eighty per-

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3. Beginning in 1975, *Annals* began to accept a small amount of classified advertising, similarly restricted to advertisements directly relevant to the practice of medicine. Typical categories of such advertising include notices of available positions, announcements of

cent of these advertisements are for prescription drugs,[4] and contain extensive information mandated by the Federal Food and Drug Administration ("FDA") concerning the use, indications and contraindications for, known adverse reactions to, and recommended dosage of each such product. (C.A. App. 20A, 35A; *see* p. 17 n. 24 & App. B, *infra*).[5] The College has a long-standing policy of accepting only those advertisements which meet these restrictions, and screens each proferred advertisement for accuracy and relevance to internal medicine. The College has rejected advertisements which have not conformed with its policy because of the type of products advertised or the inadequacy of information contained in the advertisements. (C.A. App. 20A).

The advertisements published in *Annals* are concentrated in two sections to the front and rear of the editorial copy, and are indexed. (C.A. App. 20A). The College sets advertising rates by reference to its costs and the need to be competitive with rates set by other medical journals. (C.A. App. 22A).[6]

NOTES *(Continued)*

postgraduate courses and symposia, notices of medical equipment or facilities for sale or rent, and notices of medical books and journals wanted or for sale.

4. For example, advertising in the January 1975 issue of *Annals* (Exhibit P-1 in the Claims Court) can be broken down into the following categories, calculated according to column-inch:

Prescription Drugs	80%
Medical Books	6%
Medical Classified	3%
Non-Prescription Drugs	6%
Medical Instruments	3%
Continuing Medical Education	2%

Thus, the government's characterization of the advertising in *Annals* as "the garden variety commercial type" (Pet. 20) is scarcely apt here.

5. Federal Food, Drug & Cosmetic Act, 21 U.S.C. §352(n). (1982).

6. Not surprisingly, given the FDA's role, the nature of the products advertised, and the audience involved, in some instances

Prior to 1967 the government made no effort to contend that income from advertising in a publication of a (c)(3) organization such as *Annals* was taxable, and the College did not pay taxes on such income. In 1967, however, the IRS revised its regulations implementing Section 513. In a principal — and controversial — change, the new regulations provided for the fragmentation of activities of an exempt organization so that each activity, such as the publication of advertising, had to be assessed separately to see if it constituted an unrelated trade or business. §1.513-1(b). The regulations provided that whether a trade or business activity was "substantially related" would turn on the existence of a substantial causal relationship to the achievement of exempt purposes, which would be so where the activity "contribute[s] importantly to the accomplishment of those purposes." §1.513-1(d)(2). The regulations further provided that

> [w]hether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved. [*Id.*][7]

Finally, the regulations set forth several "examples" illustrating the application of these principles. §1.513-1(d)(4). Example 5 addresses advertising in pub-

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the advertisements appearing in *Annals*, which are prepared by the advertisers, are identical to advertisements appearing in medical journals published by non-exempt organizations, such as the *American Journal of Medicine* and the *American Journal of Cardiology*. (C.A. App. 21A). The record does not reveal the extent to which this is the case.

7. The case-by-case approach of the regulations is also reflected in a provision that, if an activity is related in part to the performance of exempt functions but conducted on a larger scale than is reasonably necessary, income attributable to the excess activity is taxable. §1.513-1(d)(3). This provision, omitted from the Petition Appendix, is set forth at Appendix A *infra*.

lications of universities and other (c)(3) organizations and presents some circumstances where advertising income would not be taxable. As finally promulgated,[8] Examples 6 and 7 address publications of organizations exempt under (c)(6) and indicate circumstances where advertising income would be taxable.

Although the regulations thus did not purport to set forth a rule under which all advertising income of all exempt organizations would be deemed *per se* "unrelated" and hence taxable,[9] the fragmentation provision compelled that result as a practical matter for the many organizations (such as trade associations exempt under (c)(6)) which would not be able to show that the advertising they published contributed importantly to their exempt purpose. The resulting controversy over the validity of the fragmentation rule led to Congressional action in the Tax Reform Act of 1969.

In that Act, Congress added Section 513(c), expressly endorsing the fragmentation principle of the regulations. The statute did not otherwise address how advertising (or any other activity) of any type of exempt organization should be treated;[10] nor did it alter the factually-oriented, case-by-case approach expressly required by the regulations.

As the 1969 Act only applied prospectively, the validity of the fragmentation approach was still in issue as

8. *See* pp. 12-13 *infra*.

9. In §1.512(a)-1(f), concerning the computation and attribution of income, the regulations state generally that amounts realized from advertising in a periodical constitute income from an unrelated trade or business activity, but that section did not purport to define such income and was instead merely referring to income which was determined to be taxable under Section 513 and §1.513-1.

10. The government erroneously asserts that the statute specifically addresses "an activity, such as advertising." (Pet. 4). The *only* reference to advertising is in the title to section 513(c) ("Advertising, Etc., Activities"), to which the government repeatedly refers (Pet. 4, 7, 14), but subsection titles do not constitute law. IRC §7806(b).

to prior tax years, and the College was among the taxpayers who successfully challenged the regulation in that respect. In *American College of Physicians v. United States*, 530 F.2d 930 (Ct. Cl. 1976) ("*ACP I*"), the court held that the fragmentation regulation was invalid. The court therefore found it unnecessary to reach the College's alternative contention that the advertising in *Annals* "contribute[d] importantly" to and hence was "substantially related" to the purposes underlying the College's exemption as a (c)(3) organization. However, the court effectively determined the parameters of the instant litigation by holding that the issue of the relatedness of the advertising was an "essentially factual dispute." *Id.* at 931 n.3.

The present case arose when the College unsuccessfully sought a refund for taxes paid on the income from its publications during taxable year 1975. In the Claims Court, the government did not seek summary judgment, as would have been warranted under the *per se* rule now advocated by the Solicitor General. Rather, as required by the holding in *ACP I*, both sides treated the issue as "essentially factual." The case was tried upon a factual stipulation, documentary evidence, and testimony concerning the relationship between the advertising in *Annals* and the purposes underlying the College's exemption under Section 501(c)(3).

The College presented unrebutted testimony that the inclusion of advertising pursuant to the strict limitations of the College's policy is a key means of alerting practicing internists of the availability of new drugs and developments relating to already established drugs, and that being current with respect to available drugs and their properties is vital for the internist, thereby disseminating improvements in available treatment and raising the standard of medical care available to the physicians'

patients.[11] Each of the four witnesses presented unrebutted testimony that the advertising published in *Annals* "contribute[d] importantly" to these exempt functions.

Following trial, the Claims Court denied the petition. The Court based its decision upon a factual analysis of that relationship and concluded that the advertising had a predominantly commercial purpose that precluded it from contributing importantly to the purposes underlying the College's exemption under Section 501(c)(3). (Pet. App. 28a).[12]

On the College's appeal, the government contended that "the Statute and Regulations require a factual inquiry into the activity, and its relationship to exempt functions," that "the Claims Court conducted the required inquiry into the facts and circumstances involved," and that it "cannot be doubted that the question involved here is one of fact."[13] Similarly, in an amicus brief in support of the government's unsuccess-

11. According to the 1977 policy statement incompletely quoted by the government (Pet. 4):

> [d]rug advertisements in peer-review journals are a vital part of continuing pharmacologic education. [I]t does serve an alerting function: to provoke the physician's interest to the extent that he will look further into the drug's use by reading a contemporary pharmacology text, or ask his librarian to reproduce a few recent references from current journals, or look it up in *The Medical Letter* or *AMA Drug Evaluations*. This catching of the reader's attention is a short but important step down the track of education on drug use to more enlightened prescribing. [C.A. App. 71A].

Compare Zauderer v. Office of Disciplinary Counsel, 53 U.S.L.W. 4587, 4593 (U.S. May 28, 1985) (noting "important" attention-getting and communicative functions of illustrated advertisements for professional services).

12. Prior to 1967, the Regulations contained a "primary purpose" test, but this was replaced that year by the "contribute importantly" language. *See* T.D. 6301, 1958-2 C.B. 197, *superseded by* T.D. 6939, 1968-1 C.B. 274.

13. Brief for Appellee, pp. 3, 8, 9.

ful petition for rehearing, American Business Press emphasized that the case had been treated at trial and on appeal as "a factual dispute."[14] The College agreed that the issue was factual, and turned on the relationship between the advertising and its exempt purpose as a (c)(3) organization.[15] The College did not challenge the validity of Example 7, but argued that it was distinguishable.

The court of appeals agreed with both parties that the issue was factual. It held, however, that the Claims Court's resolution of that issue was "clearly erroneous" because it improperly gave undue weight to whether the advertising was "commercial" in nature. (Pet. App. 16a-17a). The court of appeals held that, on the record in this case, the advertising in *Annals* was shown by the College to contribute importantly to the educational purposes underlying its exemption under Section 501(c)(3). (Pet. App. 19a). The court was also unpersuaded by the argument that the legislative history of the 1969 amendment showed clearly that Congress intended to tax all advertising income in publications of all exempt organizations, and held that in any event the language of the statute did not do so. (Pet. App. 12a).

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14. Amicus Curiae Brief of American Business Press in Support of Appellee's Suggestion for Rehearing En Banc, p. 2.

15. The government did not disagree, and stated:

> In any situation in which a determination must be made as to whether a particular business activity "contributes importantly" to the exempt function of an organization, the court must first clearly identify the purposes of the organization, and then carefully inquire into how one or more of those purposes is promoted by the business activity. Since a business league is a different type of exempt organization, with a different kind of exempt function, analysis of how a business activity is directly related will naturally differ from the same inquiry involving a different organization, such as a hospital, with different exempt functions. [Brief for Appellee, p. 19.]

REASONS FOR REFUSING THE PETITION

Contrary to the government's Petition, the case before this Court was correctly decided on a narrow factual basis which will preclude more than a handful of organizations exempt from tax pursuant to Section 501(c)(3) from successfully claiming that their advertising income is not subject to any unrelated business income tax. The administrative burden resulting from the decision should be slight. The decision below did not misconstrue the applicable Code sections or Treasury regulations, but merely applied them as written. This construction admittedly does not present a conflict among the circuits requiring resolution by this Court. Thus, no "special and important" reasons exist to support issuance of the writ. Sup. Ct. Rule 17.1.

A. This Case Does Not Present the Question the Petition Asks the Court to Review, and the Court of Appeals Correctly Decided the Only Question Before It.

The government is urging a construction of Section 513 of the Internal Revenue Code which would establish a *per se* rule declaring revenue realized by a tax-exempt organization from the sale of advertising in its journals to be taxable as a matter of law, without regard to the facts of a particular case. The government describes this case as presenting a necessary choice between this *per se* rule (or perhaps an undefined presumption)[16] and what it describes as a novel, subjective, "case-by-case, ad-by-ad" approach entailing *sub silentio* invalidation of Example 7 in the regulations. Neither this choice nor even the issue of a *per se* rule is properly presented here. For several reasons, this case is a uniquely inappropriate vehicle for

16. The government's position is not entirely clear as to whether it contends for a "per se" rule or a "presumption" and, if the latter, what is its content and whether or how it may be rebutted. (Pet. 18, 19). This vagueness is an additional consideration making review unwarranted in this case.

considering the question whether Section 513(c) or Example 7 establishes a *per se* rule making income from advertising in publications of virtually all exempt organizations taxable.

1. In accordance with the Court's decision in *ACP I*, this case was litigated by both the College and the Government as presenting a factual question to be decided on the evidentiary record concerning the relationship between the advertisements in *Annals* and the charitable and educational purposes underlying the College's exemption as a (c)(3) organization. Having argued below that the case was correctly tried and decided as presenting a factual issue — as required by *ACP I* — the government cannot now argue that the case instead presents a legal issue concerning the application of a *per se* rule.[17] The government's contention for a *per se* rule can be considered more appropriately in a case where there was not a prior determination as to the factual nature of the issue and the parties did not litigate it as a factual issue.

2. The decision of the court below simply corrected the trial court's clearly erroneous factual analysis of the relationship between the advertising which appears in *Annals* and exempt purposes of the College. In an effort to transform this into a significant tax issue worthy of this Court's consideration, the government mischaracterizes the court of appeal's decision as an invalidation *sub silentio* of Example 7 in the regulations, which states that income from commercial advertising solicited by a (c)(6) organization for inclusion in a journal published by such an organization, even though limited to "products which are within the general area of profes-

17. It would be contrary to the interests of judicial economy — and unfair to litigants such as the College — if the government were permitted to reframe the litigation in the Supreme Court in an effort to present a question of law rather than of fact after endorsing the propriety of a trial, which under the government's position in this Court would have been impermissible. *See* p. 8 *supra*.

sional interests of its members," is taxable. (Pet. 8, 21-22). While it is true that the court of appeals did not discuss the validity *vel non* of Example 7, this silence is perfectly understandable because the College never challenged Example 7. It expressly waived that argument, and instead contended that Example 7 was inapplicable to a (c)(3) organization.[18] Because of the differences in purposes underlying organizations that are tax-exempt pursuant to Section 501(c)(6) — business leagues, chambers of commerce, or similar organizations formed to advance the financial interests of the particular businesses from which their memberships are drawn — and the charitable or educational functions of a (c)(3) organization such as the College, the IRS may plausibly contend that Example 7 is a shorthand determination that advertising will not have a "substantial relationship" to an exempt purpose for a (c)(6) organization (to which Example 7 was deliberately limited). The same cannot be said for a (c)(3) organization, as indicated by Example 5.

The Examples to Treasury Reg. §1.513-1(d)(4) further reflect that where they were intended to apply to all exempt organizations, no specific designation is included. Of the 79 examples in the Regulations governing the unrelated business income tax, 15 refer to specific paragraphs in Section 501(c) and 16 make general references to "exempt organizations." The remainder refer specifically to a particular type of organization (*e.g.*, "hospital," "trade association," "university"). When the Regulations originally were proposed in 1967, they did not contain Example 7 and Example 6, which provides the context for Example 7, referred only to an "exempt trade organization." 32 Fed. Reg. 5995 (1967). When the Regulations were promulgated in final form, the refer-

18. Brief for Appellant, pp. 28-31. This waiver of a challenge to the validity of Example 7 was further emphasized in the oral argument. The full text of Example 7 is contained in the Government's Petition. (Pet. App. 52a-53a).

ence to "an association exempt under Section 501(c)(6)" was inserted in Example 6 and Example 7 was added in its present form, referring to associations covered by Example 6. The specific reference in Examples 6 and 7 to a 501(c)(6) organization, therefore, is not random or without significance.

The court of appeals obviously agreed that Example 7 was inapplicable. Thus, the issue of the validity of Example 7 simply does not arise in this case.[19]

The court of appeals held that the College was entitled to prove that the advertising in *Annals* contributed importantly to the educational purposes underlying the College's exemption as a (c)(3) organization, and that it had made such a showing. That ruling was consistent with Section 513 and the regulations, as demonstrated above.

The government's argument to the contrary rests largely on statements in the legislative history by opponents to the 1969 amendment in which Congress adopted the "fragmentation" language in Section 513(c). As noted above, the 1969 amendments left wholly unchanged the "substantial relationship" test, nowhere stated the *per se* rule which the government now advances, and did not alter the regulations providing that whether advertising or any other activity "contribute[s] importantly" to an organization's exempt purpose

19. Despite the government's protestations that Example 7 has been judicially overruled and that the revenue results will be substantial, the IRS, through Howard Schoenfeld, special assistant for exempt-organization matters, recently told a briefing sponsored by the American Association of Association Executives that the case was "a factually narrow dispute that is not of as much benefit to associations as they would like to think." *Inside ASAE*, Vol. 1, No. 18, p. 2 (March 22, 1985). Similarly, the Petition actually stops short of asserting unequivocally that the decision has broad application (using qualifiers throughout such as "plausibly" and "apparently"). (Pet. 22, 24). It can also be expected to argue in future instances involving (c)(6) organizations that the decision below applies only to a (c)(3).

"depends upon the facts and circumstances." Since both the statute and regulations unambiguously contradict the existence of a *per se* rule, resort to the legislative history is unnecessary, if not inappropriate.[20] *United States v. Oregon*, 366 U.S. 643, 648 (1961).

The government argues that because testimony at the time of the amendment was heard from various publishers of professional journals, including the College, urging that their advertising substantially contributed to the accomplishment of exempt purposes, the 1969 amendments to the Code constituted a legislative rejection of their position. It is equally logical to assume, however, as the court of appeals did below, that Congress' retention of the "substantial relationship test," and its failure to simply classify advertising revenues as taxable income if that was what it intended to do, was a clear rebuff of the *per se* position and a recognition that advertising income of certain organizations might still qualify for exemption. (Pet. App. 13a). As the court of appeals stated below, "[W]hile the committee may have believed that advertising income should be taxed, it did not adopt a blanket rule." (Pet. App. 12a).

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20. The court of appeals correctly noted that "[t]he legislative history addresses advertising generally and does not grapple with specific factual situations." (Pet. App. 13a). The general statements in the committee reports on which the government relies (Pet. 15, 16), if read as stating that all advertising income of all exempt organizations would be taxable, cannot be squared with the portion of Section 513 that was not amended, the facts-and-circumstances test of the Regulations, and Example 5 of Treas. Reg. §1.513-1(d)(4). Those statements are best understood as reflecting an understanding that relatively few exempt organizations — and perhaps no (c)(6) organizations — would be able to make a factual showing that the advertising in their publications "contribute[s] importantly" to the purposes underlying their exemption. The decision below is not to the contrary.

B. The Government Overstates the Impact of the Decision Below

The government argues that the decision below will have a substantial but unquantified impact on revenues (Pet. 23-24), and, by assertedly creating a new requirement of case-by-case factual analysis, will pose "an almost insurmountable audit problem." (Pet. 24). Both contentions rest upon the government's erroneous premise that the decision below is broad in scope and applies to all exempt organizations. In any event, neither contention is correct, and the government's exaggerated "parade of horrors" cannot withstand close examination. The decision below, merely correcting the trial court's factual analysis of the relationship between the advertising in *Annals* and the College's exempt goals as a (c)(3) organization, should not have major impact.[21]

Many tax-exempt organizations that publish journals are exempt pursuant to Section 501(c)(6). As to them, Example 7 will still remain as an obstacle to avoiding a tax on advertising income. Even among the (c)(3) organizations, few are likely to be able to offer the unrebutted testimonial proof which the College offered below that its advertising, even if having a commercial character, still bears a substantial relationship and contributes importantly to the accomplishment of its exempt purposes. Few are likely to be able to point to a connection so significant as the premiere role of advertising in apprising or reminding practicing internists of new pharmaceutical developments and other important information.[22]

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21. Significantly, President Reagan's recent 500-page proposal for extensive revisions to the Internal Revenue Code, released after the Petition in this case, did not feel it necessary to address this issue nor any issue related to the unrelated business income tax.

22. It is difficult to imagine *National Geographic* or a college alumni magazine, for example, successfully establishing a substantial relationship between the advertising carried in their pages and exempt goals of their underlying organizations.

The data presented by the government thus become largely irrelevant. We are advised by IRS that all three of the medical journals named by the government as having substantial advertising revenues (Pet. 23) are published by (c)(6) organizations. Of the 45 journals published by exempt organizations identified by the government as among the 400 largest (Pet. 23), only 22 are published by organizations exempt pursuant to Section 501(c)(3), and only three of these journals appear to contain "substantially related" advertising.[23] The government refers to proposed tax deficiencies of $29.6 million based upon examinations over *two* years, of *all* forms of tax-exempt periodicals (Pet. 23-24), but there is no indication of the extent to which (c)(3) organizations were involved.

The government's speculations as to "formidable burdens on IRS audit resources" (Pet. 24) similarly are unpersuasive. As required by the Code and the Regulations, IRS already performs a factual analysis with respect to advertising and other business activities. *See, e.g.*, Section 513(a)(2) (activities carried on primarily for convenience of members exempt); Treas. Reg. §1.513-1(d)(3) (IRS must determine whether activity is conducted on "larger scale than is reasonably necessary"); Treas. Reg. §1.513-1(d)(4) Example 5 (advertising revenue from college newspaper exempt); Rev. Rul. 73-104 (sale of greeting card reproductions of art works by mu-

23. The names of the 45 magazines were provided to us by IRS. We compared the list of publishers to the Cumulative List of Organizations described in Section 170(c) (Publication 78) published by IRS on the assumption that the organizations listed therein are qualified under Section 501(c)(3). We then sought to examine the magazines published by the 22 organizations listed in Publication 78 to determine the nature of the advertising. Four of the publications could not be located and we questioned the organizations by telephone as to the nature of their advertising, if any. Based on this review, we concluded that only three of the publications (other than *Annals*) contained advertising which could be argued to be "substantially related."

seum exempt). The few (c)(3) returns that might require factual analysis as a result of this case should not require any unusual IRS effort.

As for the government's suggestion that exempt organizations will attempt to "manipulate" their tax outcome by advising their advertisers to insert "incidental 'educational' boilerplate" in their ads (Pet. 25), any such "incidental" matter is unlikely to satisfy the "contribute importantly" test. This unfounded suggestion is particularly out of bounds in this case, where the vast majority of the advertising is for prescription drugs, and its informational content so important that it is mandated (if not "manipulated") by the government itself.[24]

Finally, the government urges that the decision below will "flout" a "sharply defined legislative policy" to prevent unfair competition between exempt and non-exempt organizations in business activities. (Pet. 25). The short answer is that Congress clearly contemplated that income from a trade or business activity bearing a substantial relationship to exempt purposes should be exempt from tax despite the existence of non-exempt competitors. The mere existence of such competitors is thus irrelevant. *See* Rev. Rul. 80-295, 80-296, 1980-2 C.B. 194, 195. Furthermore, the government's suggestion that the College will charge lower rates for advertising based upon its income tax status is merely speculative, and contradictory to its Stipulation below that rates are set by relation to the College's costs in publishing the ads and the need to be competitive with other

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24. Unfortunately, here the government itself has engaged in some "manipulation," by emphasizing in its Appendix the relatively few advertisements which appeared for over-the-counter products, and by totally deleting from the advertisements for prescription drugs the detailed technical information they contain. To correct any misimpression the government's selective editing otherwise may create, the College has included in Appendix B an example of the information deleted from the ad for "Anspor" incompletely reproduced at Pet. App. 73a.

journals. (C.A. App. 22A). A decision that the advertising in *Annals* is not subject to tax is not likely to affect either the journal's circulation, or that of any of its commercial competitors. The tax burden, on the other hand, would lessen the funds available for the College's other educational activities.

Should any of the government's speculations come to pass, the government still possesses ample means to address the problem without recourse to this Court in the present case. If significant numbers of (c)(6) organizations challenge Example 7 and claim exemption, the issue of the determination of the Example's validity will then be ripe, either in other circuits (where some cases involving (c)(6) organizations are already pending) or in the court below. The government can obtain a clear ruling on a *per se* rule by seeking summary judgment in a more appropriate case, rather than by endorsing factually oriented litigation. The IRS could also issue a clarification to Example 7 expressly stating the statutory basis for a *per se* rule for commercial advertising in publications of (c)(6) organizations, or could devise reporting requirements designed to alert it to returns reflecting a claim of substantially related advertising. Should "unfair competition," substantial audit burdens, or significant loss of revenue occur, and if the legislative intent is half as clear as the government contends, Congress can provide appropriate clarification. This case is a premature and inappropriate vehicle for the resolution of these issues.

C. No Conflict Exists Requiring Resolution by This Court

The government concedes that this case presents no conflict among the circuits which requires resolution by this Court. (Pet. 25). It notes, in fact, the existence of three suits pending outside of the Federal Circuit presenting the issues addressed by the government in its petition, all as yet undecided. (Pet. 25 n.14). Indeed, the

government appears to be arguing that this Court should review the decision below *because* there is no conflict and the Federal Circuit offers a nationwide forum for taxpayers to litigate their refund claims. This Court's Rules, however, specifically provide that review of decisions of the Court of Appeals for the Federal Circuit is to be controlled by the same considerations applicable to the review of decisions of all other courts. Sup. Ct. Rule 17.2.[25]

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25. Furthermore, that court was created to render decisions of nationwide application in certain specialized areas of the law, to which its jurisdiction is limited, in order to lessen the need for resort to this Court. S. Rep. No. 275, 97th Cong., 2d Sess. 3-4 (1981), *reprinted in* 1982-2 *U.S. Code Cong. & Ad. News* 13-14. *Cf.* NYU Sup. Ct. Project, Executive Summary 67 (1985) (identifying tax litigation as an area where the Court should not "feel strongly any temptation to intervene" by reviewing decisions of the Court of Appeals for the Federal Circuit. The judges appointed to the Court of Appeals for the Federal Circuit possess significant and specialized expertise in these areas. Judge Smith, for example, the author of the opinion below, served as the Chief of the Trial Section of the Tax Division of the United States Department of Justice, followed by a distinguished career in private tax practice. Thus, the government's argument that the jurisdiction of the court below somehow gives its decisions a special claim to the attention of this Court completely subverts the Congressional intent.

CONCLUSION

For the foregoing reasons, the government's petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

Appendix A

Treasury Regulations on Income Tax (1954 Code)

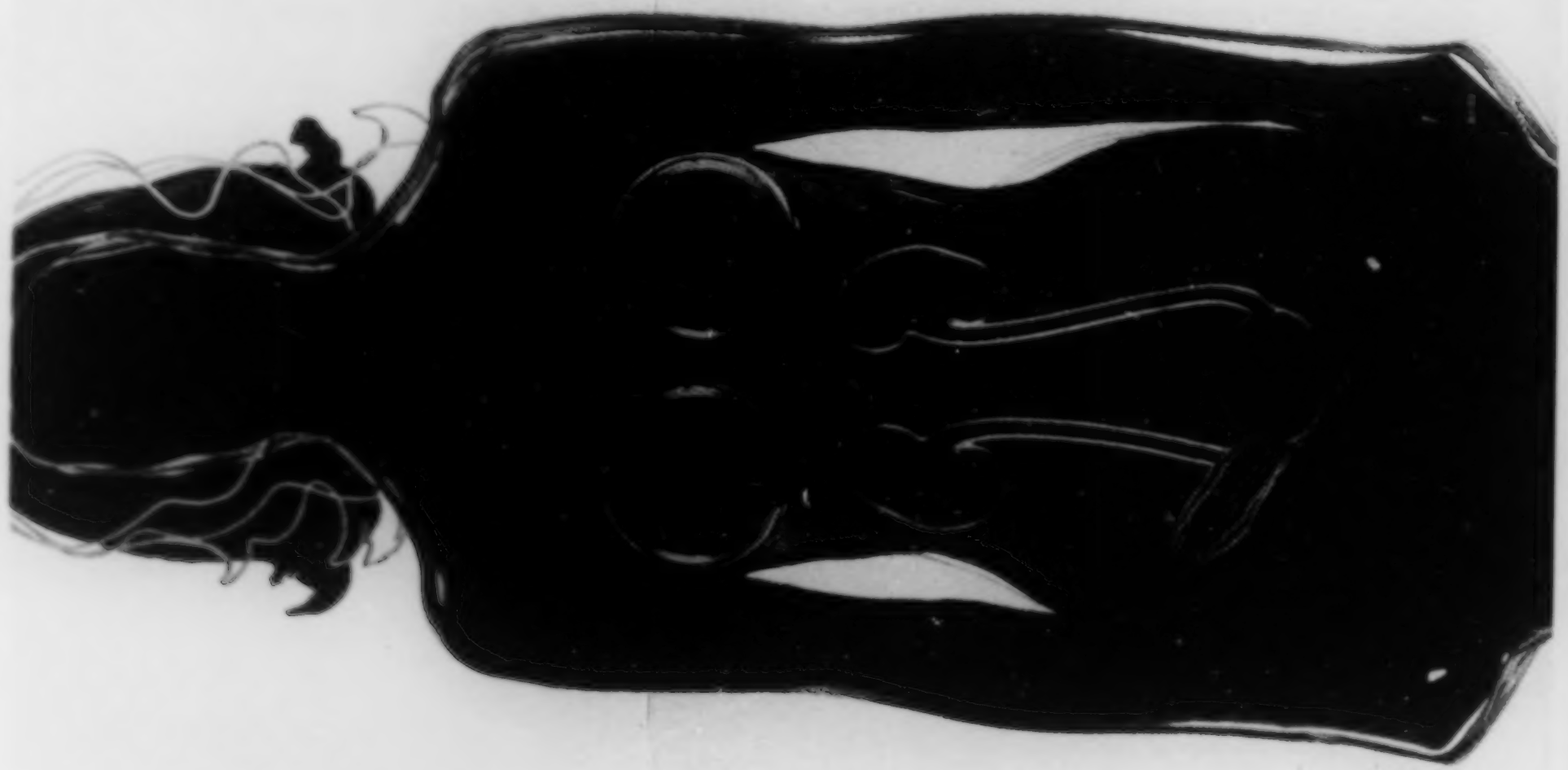
1.513-1(d)(3). Size and extent of activities. In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

New from SK&F

AMPICEPHRADINE™

BRAND OF CEPHRADINE

capsules: 250 and 500 mg.
for oral suspension: 125 and 250 mg./5 ml.



SK&F
SMITH KLINE
& FRENCH
LABORATORIES

BEST AVAILABLE COPY

A New Oral Antibiotic with these Important Features:

- **Bactericidal activity *in vitro*.**
- **Effective against a wide range of Gram-positive and Gram-negative infections due to susceptible organisms:**

  Respiratory tract infections caused by group A beta-hemolytic streptococci and *D. pneumoniae*.

  Urinary tract infections caused by *E. coli*, *Pr. mirabilis*, and *Klebsiella* species.

  Skin and soft-tissue infections caused by staphylococci.

  Otitis media caused by group A beta-hemolytic streptococci, *D. pneumoniae*, *H. influenzae* and staphylococci.

  Culture and susceptibility tests should be initiated prior to and during therapy. Renal function studies should be performed when indicated.

- **Documented safety.**
- **Rapidly absorbed. Average peak serum levels within 1 hour.**
  (Approximately 9 and 16.5 mcg./ml. at 1 hour with 250 and 500 mg. capsules, respectively, in normal adult volunteers.)
- **High urinary levels.**
  (Peak concentration of approximately 3200 mcg./ml. with 500 mg. capsule dose in normal adult volunteers.)
- **Excreted essentially unchanged in the urine.**
- **Acid stable. Can be given without regard to meals.**

'Anspor' is contraindicated in patients with known hypersensitivity to the cephalosporins. **In penicillin-sensitive patients, cephalosporin C derivatives should be used with great caution because of evidence of partial cross-allergenicity of the penicillins and the cephalosporins.**

Adverse Reactions

The following adverse reactions have been reported: glossitis, nausea, vomiting, diarrhea or loose stools, abdominal pain and heartburn; mild urticaria or skin rash, pruritus, joint pains; transient eosinophilia, leukopenia, neutropenia; transient rise of SGOT, SGPT, total bilirubin, BUN; dizziness, tightness in the chest, and candidal vaginitis.

For a brief summary of prescribing information, including indications, contraindications, warnings, precautions, adverse reactions, and dosage, please see the following page.

New from SK&F

ANSPOR™

BRAND OF

CEPHRADINE



capsules: 250 and 500 mg.
for oral suspension: 125 and 250 mg./5 ml.

Before prescribing, see complete prescribing information in SK&F literature. The following is a brief summary.

DESCRIPTION

Anspor (cephradine, SK&F) is a semi-synthetic cephalosporin antibiotic chemically designated as 7-[D-2-amino-2-(1,4-cyclohexadien-1-yl) acetamido]-3-methyl-8-oxo-5-thia-1-azabicyclo[4.2.0]-oct-2-ene-2-carboxylic acid.

ACTIONS

Microbiology: *In vitro* tests demonstrate that the cephalosporins are bactericidal because of their inhibition of cell-wall synthesis. Cephradine is active against the following organisms *in vitro*:

Beta-hemolytic streptococci	*Diplococcus pneumoniae*
Staphylococci, including coagulase-positive, coagulase-negative, and penicillinase-producing strains	*Escherichia coli*
	Proteus mirabilis
	Klebsiella sp.
	Hemophilus influenzae

Note—Some strains of enterococci (*Streptococcus faecalis*) are resistant to cephradine. It is not active against most strains of *Enterobacter* sp., *Pr morganii* and *Pr vulgaris*. It has no activity against *Pseudomonas* or *Herellea* species. When tested by *in vitro* methods, staphylococci exhibit cross-resistance between cephradine and methicillin-type antibiotics.

INDICATIONS

Anspor (cephradine, SK&F) is indicated in the treatment of the following infections when caused by susceptible strains of designated micro-organisms.

Infections of the respiratory tract (e.g., tonsillitis, pharyngitis, and lobar pneumonia) caused by group A beta-hemolytic streptococci and *D pneumoniae*

(Penicillin is the usual drug of choice in the treatment and prevention of streptococcal infections, including the prophylaxis of rheumatic fever. 'Anspor' is generally effective in the eradication of streptococci from the nasopharynx; substantial data establishing the efficacy of 'Anspor' in the subsequent prevention of rheumatic fever are not available at present.)

Otitis media caused by group A beta-hemolytic streptococci, *D pneumoniae*, *Hemophilus influenzae* and staphylococci.

Infections of the skin and soft tissues caused by staphylococci.

Infections of the urinary tract, including prostatitis, caused by *Escherichia coli*, *Pr mirabilis*, and *Klebsiella* species.

Note—Culture and susceptibility tests should be initiated prior to and during therapy. Renal function studies should be performed when indicated.

CONTRAINDICATIONS

Anspor (cephradine, SK&F) is contraindicated in patients with known hypersensitivity to the cephalosporin group of antibiotics.

WARNINGS

IN PENICILLIN-SENSITIVE PATIENTS, CEPHALOSPORIN C DERIVATIVES SHOULD BE USED WITH GREAT CAUTION. THERE IS CLINICAL AND LABORATORY EVIDENCE OF PARTIAL CROSS-ALLERGENICITY OF THE PENICILLINS AND THE CEPHALOSPORINS, AND THERE ARE INSTANCES OF PATIENTS WHO HAVE HAD REACTIONS TO BOTH DRUGS (INCLUDING FATAL ANAPHYLAXIS AFTER PARENTERAL USE).

Any patient who has demonstrated some form of allergy, particularly to drugs, should receive antibiotics cautiously and then only when absolutely necessary.

Usage in Pregnancy and Lactation: Safety of this product for use in pregnancy has not been established. Cephradine is secreted in breast milk during lactation.

PRECAUTIONS

Follow patients closely to detect side effects or unusual manifestations of drug idiosyncrasy. If hypersensitivity reaction occurs, discontinue drug and treat patient with usual agents, e.g., pressor amines, antihistamines, or corticosteroids.

Administer with caution in presence of markedly impaired renal function. In known or suspected renal impairment, careful clinical observation and appropriate laboratory studies should be made prior to and during therapy as cephradine accumulates in the serum and tissues. See *DOSAGE AND ADMINISTRATION* section for information on treatment of patients with impaired renal function.

Prolonged use of antibiotics may promote the overgrowth of non-susceptible organisms. Take appropriate measures if superinfection occurs during therapy.

After cephradine therapy, a false positive reaction for glucose in the urine may occur with Benedict's solution, Fehling's solution, or with Clinitest® tablets, but not with enzyme-based tests such as Clinistix® and Tes-Tape®.

A positive Coombs test may be due to the drug.

Indicated surgical procedures should be performed in conjunction with antibiotic therapy.

ADVERSE REACTIONS

The following adverse reactions have been reported:

Gastrointestinal: Glossitis, nausea, vomiting, diarrhea or loose stools, abdominal pain and heartburn.

Skin and Hypersensitivity Reactions: Mild urticaria or skin rash, pruritus, and joint pains.

Blood: Mild, transient eosinophilia, leukopenia and neutropenia.

Liver: Transient mild rise of SGOT, SGPT, and total bilirubin with no evidence of hepatocellular damage.

Renal: Transitory rises in BUN. In adults for whom serum creatinine determinations were performed, the rise in BUN was not accompanied by a rise in serum creatinine.

Other adverse reactions have included dizziness and tightness in the chest and candidal vaginitis.

DOSAGE AND ADMINISTRATION

Anspor (cephradine, SK&F) may be given without regard to meals.

Adults: For skin and soft-tissue and respiratory tract infections (other than lobar pneumonia), the usual dose is 250 mg. q.i.d. in equally spaced doses. For acute infections of the urinary tract, including prostatitis, and pneumococcal lobar pneumonia, the usual dose is 500 mg. q.i.d. in equally spaced doses; severe or chronic infections may require larger doses.

Children: The usual dose is 25 to 50 mg./kg./day total, q.i.d. in equally divided and spaced doses. For otitis media due to *H. influenzae*, doses from 75 to 100 mg./kg./day in equally divided and spaced doses are recommended. Maximum dose should not exceed 4 grams per day.

All patients, regardless of age and weight: Larger doses (up to 1 gram, q.i.d.) may be given for severe or chronic infections.

In patients with impaired renal function, a modified dosage schedule is necessary. Consider each patient individually utilizing the following guideline: In adults, initial loading dose is 750 mg. and maintenance dose is 500 mg. at following time intervals: creatinine clearance >20 ml./min., 6-12 hours between doses; creatinine clearance 15-19 ml./min., 12-24 hours between doses; creatinine clearance 10-14 ml./min., 24-40 hours between doses; creatinine clearance 5-9 ml./min., 40-50 hours between doses; creatinine clearance <5 ml./min., 50-70 hours between doses. Further modification may be necessary in children.

HOW SUPPLIED

ANSPOR (cephradine, SK&F) Capsules—250 and 500 mg.

'ANSPOR' for Oral Suspension—Pleasant fruit-flavored oral suspension which, after reconstitution, provides 125 mg. or 250 mg. of cephradine per 5 ml. teaspoonful.

SK&F Smith Kline & French Laboratories
Division of SmithKline Corporation, Philadelphia, Pa. 19101

BEST AVAILABLE COPY

A New Oral Antibiotic